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Cases.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924.

UNITED STATES OF AMERICA and FRANK K. BOWERS, Collector of Internal Revenue, Petitioners, AGAINST ALFRED C. COXE, JR., as Receiver of JONES & BAKER, Alleged Bankrupts.	No. 516.

BRIEF FOR RESPONDENT, ALFRED C. COXE, JR., AS RECEIVER OF JONES & BAKER.

This case comes before this Court on certiorari allowed to the Circuit Court of Appeals for the Second Circuit, where it was heard and decided at the same time as *In re Finkelstein,* one opinion being written in both cases (Rec. p. 49).

Substantially the same question of law is involved in both cases, viz:

Is a claim for income taxes, assessed against an individual, provable in bankruptcy against the assets of the firm of which he was a member, where the partnership assets are concededly insufficient to pay the firm's debts?

The order of the District Court, affirmed by the Circuit Court of Appeals, provided:

> "Ordered that the claims filed herein by the United States for income taxes due from William R. Jones in the amount of $273,739.07, and from Jackson B. Sells in the amount of $5,518.41, be disallowed and expunged as claims against the assets of the firm of Jones & Baker" (Rec. p. 48).

Facts.

The partnership of Jones & Baker, composed of two partners, William R. Jones and Jackson B. Sells, was engaged in the stock brokerage business in New York City and other cities until the 31st day of May, 1923. On that date an involuntary bankruptcy proceeding was commenced against the firm in the United States District Court for the Southern District of New York, and Alfred C. Coxe, Jr., was appointhed Receiver for the firm (Rec. p. 36).

An offer of composition in bankruptcy was then made by the firm to the partnership customers and creditors, *as distinguished from the creditors of the individual partners,* which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, the date of the receivership, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. *No offer of composition was made to the creditors of the individual partners.* The individual partners however had separate estates insufficient to pay their separate creditors including the claims filed for taxes. This offer of composition was confirmed by the District Court, and the Re-

ceiver directed to carry it into effect. Under the composition the creditors of the firm of Jones & Baker cannot by any possibility recover the full amount of their claims (Rec. pp. 38-39).

In July, 1923, more than one month after the appointment of the Receiver, the Government, upon a re-examination of the individual tax returns of Jones and Sells, the individual partners, for the years 1918, 1919 and 1920, assessed certain *additional* income taxes against Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims are entitled in the bankruptcy proceeding, and are specifically stated to be against the individuals.

The Jones Claim reads (Rec. p. 41):

"Comes Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for internal revenue taxes," describing the claim as for income tax for the year 1920, amount $632,768.04, and stating "that no part of the tax has been paid, but that the tax is now due and payable."

The Sells claim (Rec. p. 43) is in identically the same language, excepting that it states "that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for internal revenue taxes, as follows:" describing the claim as for income tax for the year 1920, amount $62,661.89.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts, namely, against Jones for $534,149.42, as net additional income taxes for the years 1918, 1919 and 1920, and against Sells for $54,872.02, as net additional income taxes for the same period (Rec. pp. 42-43).

There then followed negotiations with the Commission of Internal Revenue, and as a result a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and William R. Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,-739.07. Under the same date a similar stipulation was entered into with Jackson B. Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned (Rec. pp. 39-40).

Although it was evident upon the face of the claims and from all the facts surrounding them that these claims were merely against the individuals composing the partnership, the Government has endeavored in the bankruptcy proceeding to assert them as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm. Furthermore, the Government has endeavored to enforce the two claims as being entitled to payment out of the firm's assets, prior to the creditors of the firm.

On motion of the Receiver, and after full hearing, the District Court directed that the two claims of the United States be expunged and disallowed against the assets of the firm of Jones & Baker (Rec. p. 45).

The Circuit Court of Appeals unanimously affirmed the order (Rec. p. 58).

In the *Finkelstein* case the tax was assessed against the taxpayer prior to the bankruptcy, but as creditors of the partner could have no right to partnership property until all partnership liabilities were paid, we do not believe it important whether the tax was assessed prior to, or after the bankruptcy proceeding was commenced. However, we call the Court's attention to the fact that in the *Jones & Baker* case the tax was not even assessed until after the bankruptcy petition had been filed.

In the government's brief (p. 3) it is stated that there were no separate individual estates. There is nothing in the record in this case that supports any such statement, and as a matter of fact, both Jones and Sells as individuals had separate estates which have come into the hands of the Receiver. Neither estate is, however, sufficient to pay the claims filed against the individuals by the government for taxes. No offer of composition was made by the individuals and the composition which was confirmed related solely to partnership creditors.

It was stipulated in the court below (Rec. p. 45) that if the court was of the opinion that it was material in determining the claims asserted by the government, to ascertain whether or not the individuals had obtained their income from the partnership estate, further proof could be offered by the parties.

POINT I.

The claims in question are for taxes assessed against William R. Jones and Jackson B. Sells, as individuals only, and are therefore debts of the individuals, and not debts of the partnership estate.

We understand this is conceded.

An examination of the proofs of claim filed by the Government with the Receiver shows clearly that the Government regarded the claims as individual debts of the individual partners, Jones and Sells, for taxes upon their individual incomes. The claim against Jones states "that W. R. Jones, bankrupt, is justly and truly indebted to the United States of America for Internal Revenue taxes", naming the amount. The Sells claim states in identically the same language "that Jackson B. Sells, bankrupt, is justly and truly indebted to the United States of America for Internal Revenue taxes", and states the amount (Rec. p. 41).

Furthermore, the stipulations already referred to reducing the taxes previously claimed were entered into separately by the Commissioner of Internal Revenue with each partner and signed by each partner as the taxpayer. No mention whatsoever is made in either stipulation of the other partner, or of the tax claimed to be due from him (Rec. pp. 39-40).

Moreover, under the 1918 Revenue Act, these taxes could only be assessed against the individuals.

Sections 218-*a* and 224 of the 1918 Revenue Act provide as follows:

> "Sec. 218 (*a*) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."
>
> "Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

The partnership is not made liable for the payment of taxes. It is merely required to furnish the necessary information return to enable the Government properly to determine the amount of income tax assessable against the individual partners. This was not true under the prior 1917 Act, which imposed a graduated excess profits tax upon the partnership. (Title II, Sec. 201, Rev. Act of 1917.)

POINT II.

The question here is not one of prior right, but as to the estate against which the claims in question can be asserted.

The argument presented on behalf of the Government in their brief misses this point entirely and argues a proposition which is not disputed, viz: that a claim for taxes is entitled to priority of payment out of the assets of the taxpayer against whom

it is assessed. We do not here question that right. But that is not the right which was asserted and passed on by the Courts below. The right asserted was to have a tax claim against the individual partner, paid out of firm assets, before firm creditors were paid in full. The Circuit Court of Appeals well said, as to this (Rec. p. 55):

> "The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible."

How unsound the argument for the Government is can be seen by considering the statement at page 11 of their brief, which reads as follows:

> "Certainly Congress did not intend that a partner by his own acts should place rights to property or income beyond the reach of taxing authorities and therefore deprive the Government of tax in violation of the plain intent of all the law."

Can it be possible that they mean that if an individual spends, loans or gives away all his income and does not retain enough to pay the tax which the Government will later assess against him, that the Government can pursue that income into the possession of the merchants to whom the individual paid it, or have any more right to recover it from persons who have received it in good faith than the individual would have. That would be the logical conclusion of such an argument.

Certainly there were no surplus profits in this estate when the Receiver took possession, because the assets are concededly insufficient to pay the partnership creditors.

Upon the bankruptcy of a partnership, the law is well established that there must be a marshalling

of assets and liabilities, and firm liabilities are to be paid out of firm assets and individual liabilities out of individual assets.

The provisions of the 1898 Bankruptcy Act relating to the marshalling of assets in partnership cases, are found in Section 5, subdivision *f*, as follows:

> "The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership."

This section of the Bankruptcy Act has frequently been before the Federal Courts for construction, and it has been repeatedly held that the distinction between individual and firm debts is a matter of substance and cannot be disregarded.

In re Wilcox, 94 Fed. 84;
In re Janes, 133 Fed. 912;
In re Schall vs. *Camors,* 251 U. S. 239.

In *Schall* vs. *Camors* (*supra*) Mr. Justice Pitney, at pages 254 and 255 of the opinion, used the following language:

> "Section 5 of the Bankruptcy Act (30 Stat. 547-548), establishes on a firm basis the respective equities of the individual and firm creditors. Hence the distinction between indi-

vidual and firm debts is a matter of substance, and must depend upon the essential character of the transactions out of which they arise."

In re Janes (*supra*) Judge Lacombe writing for the Circuit Court of Appeals, in the Second Circuit, said as follows:

> "We are of the opinion that the rule to be applied is the rule laid down in the sections above quoted from the bankrupt act. It was within the discretion of Congress to leave this subject of the marshalling of assets to the courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshalled, and it has done so in language broadly covering this case as well as all the others. The language is plain, explicit, and unambiguous; it names no 'exception;' its phraseology conveys no intimation that any 'exception' is contemplated. To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation. For this reason, we have reached the conclusion above expressed" (p. 913).

In re Wilcox (*supra*) Judge Lowell traced the history and development of the marshaling rule through the many conflicting decisions, and elaborately discussed the various reasons given by the Courts in its support. His conclusion was that the Bankruptcy Act had dealt with the subject in a clear and comprehensive way and that the language of the marshaling section admitted of no exceptions. Whatever may have been the theoretical justification for the rule, the fact remains that in the present case the firm creditors have a clear right to insist that the firm and individual assets be mar-

shaled between the firm and individual creditors. Otherwise, the individual tax debt of Jones (*which is nearly fifty times that of Sells*) will be used to deplete the firm assets available for distribution to the firm creditors with no corresponding benefit to the firm creditors remaining unpaid.

The provisions of the Bankruptcy Act and the Revised Statutes, giving priority to tax claims, merely make the Government a preferred creditor in the collection of taxes from an estate against which the Government has a lawful claim; these provisions do not create or attempt to create any liability upon an estate against which the Government has no lawful claim.

The Government's contention here is the result of confusing the question of priority with that of identity of the fund or person against whom the claim can be made at all.

Section 64-*a* of the Bankruptcy Act of 1898 provides as follows:

> "The Court shall order the Trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, County, District, or Municipality, in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment, he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax, the same shall be heard and determined by the Court."

The provisions of the Revised Statutes relating to priority are as follows:

> "Section 3186.—Lien for Taxes. If any person liable to pay any tax neglect or refuses to pay the same after demand, the amount shall be a lien in favor of the United States

from the time when the assessment list was received by the Collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may occur in addition thereto, upon all property and rights to property belonging to such person; * * *."

"Section 3466.—Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

"Section 3467. Every executor, administrator or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

There is nothing in the above provisions to change the individual tax debts of Jones and Sells into partnership debts. By Section 64-*a* of the Bankruptcy Act, quoted above, the Trustee is directed "to pay all taxes legally due and owing by the bankrupt." The "Trustee" referred to must necessarily be the trustee of the estate of the person who owes the debt to the United States. Not the trustee of another estate. The only taxes legally due and owing in the present case are by Jones and

Sells as individuals, and not by the partnership. The provisions of the priority sections of the Revised Statutes are similar to Section 64-*a* of the Bankruptcy Act. Section 3186 provides that "if any person liable to pay any tax, neglects or refuses to pay" there is to be "a lien upon all property and rights of property belonging to such person." Similarly, it is provided in Section 3466 that "whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied." Here, the persons "liable to pay" and the persons "indebted to the United States" are the individual partners of the firm of Jones & Baker. The partnership is not liable to pay these taxes, and it is in no way "indebted to the United States".

The Government's right of priority in the collection of taxes is an attribute of sovereignty (*Marshall* vs. *New York,* 254 U. S. 380). But this right of priority does not create a new liability where no such liability existed prior to bankruptcy. It merely binds the property of the *tax debtor* under what "has been likened to an equitable lien" (Mr. Justice Brandeis in *Marshall* vs. *New York* (*supra*), at page 386), and permits collection of the Government's prior claim in advance of the claims of other creditors against the same estate.

The individual tax debts of Jones and Sells cannot be paid from the partnership estate until all of the firm creditors have been paid in full.

It is elementary that a partner's individual creditors have no direct interest in partnership property. They can neither attach nor levy execution against the assets of the firm (*N. Y. Partnership Law,* Section 51). Their remedy is to sequester the debtor partner's interest in the firm by appropriate

equitable proceedings (*Ib.*, Section 54). The Government is in no different position with respect to the collection of these individual tax claims from the partnership assets than any other creditor of the individual partners.

Prior to the institution of the bankruptcy proceedings against Jones & Baker, the Government could not have proceeded against the partnership property by distraint or by other summary action prescribed by the Revenue Act. It had no interest in the partnership until the firm debts were fully paid. And when the bankruptcy proceedings were commenced, the provisions of the Bankruptcy Act regarding the marshalling of assets between firm and individual creditors automatically attached. These provisions were binding upon the Government.

That the Bankruptcy Act does bind the United States, and that its rights as well as the rights of other creditors are to be determined by the provisions of that Act, is settled by the construction placed on the Act by this Court.

> *Guarantee Company* v. *Title Guaranty Company*, 224 U. S. 152;
> *Sloan Shipyard* v. *United States Foreign Corporation*, 258 U. S. 549, 574;
> *U. S.* v. *Childs*, 69 Law Ed. 124.

In *Guarantee Co.* v. *Title Co., supra*, this Court, at page 160, referring to the present Bankruptcy Act, said:

> "The Act takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state and individual, and assigns the order of payment."

In *United States of America, Petitioner* v. *Edward H. Childs, Trustee in Bankruptcy of J. Men-*

ist Co., decided by this court November 24, 1924 (Advance Opinion 69 Law Ed., 124) this court said:

> "* * * And notwithstanding the taxes are treated as debts within the meaning of the Bankruptcy Act. *In re Sherwoods,* 210 Fed., pages 754, 158; *Kaw* v. *Boiler Works* v. *Schull,* 230 Fed. 587.

This construction has been put upon the decisions of this Court by the Circuit Courts of Appeals in several circuits.

In the Fourth Circuit, in the case of *Davis* v. *Pringle,* 1 Fed. R. (2d) 860, the Court said:

> "We find no binding authority opposed to the conclusion that the United States has no priority in bankruptcy except for taxes. On the contrary we venture to think it is supported by the reasoning and conclusion of the Court in *Guaranty Company* v. *Title Guarantee Company,* 224 U. S. 152."

In the Eighth Circuit, in the case of *In re Minot,* 298 Fed. 853, the Court said:

> "The fundamental error which pervades the argument of counsel is the assumption that the Bankruptcy Act of 1898 (Comp. St. Sections 9585-9656) does not operate upon and bind the Government of the United States; that the Bankruptcy Acts of 1800 (2 Stat. 19), 1841 (5 Stat. 440) and 1867 (14 Stat. 517) did not have that effect may be conceded; but the Bankruptcy Act of 1898 evinces a change of policy in that respect on the part of Congress and is binding upon the Government of the United States," * * *
>
> "That case [*Guarantee Co.* v. *Guaranty Trust Co.*], however, on that precise point, on appeal was reversed by the Supreme Court of

the United States, and the rule was laid down, and is now well settled, that the United States is bound by the provisions of the Bankruptcy Law of 1898. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152, 32 Sup. Ct. 457, 56 L. Ed. 706."

In the Second Circuit, *In re Anderson*, 279 Fed. Rep. 525, the Court at page 529 said:

> "The United States must file its claim for taxes as any other creditor, if it desires to share in the estate and the Court must determine any question arising as to the amount or legality of such tax."

See also *United States* v. *Wood*, 290 Fed. Rep. 109.

The individual tax claims against Jones and Sells were thereby excluded from participation in the firm assets.

United States vs. *Hack*, 8 Peters, 271; 8 Lawyers' Ed. 941;

United States vs. *Evans*, No. 15062 Fed. Cases, Vol. 25;

Matter of Flatau vs. *Stern*, 21 A. B. R. 352.

In *United States* vs. *Hack* (*supra*) decided in 1834, the United States sued the assignees of John and Jacob Stouffer, bankrupt partners, on a judgment recovered against Jacob Stouffer, one of the partners, individually, on Customs House bonds. The property in the hands of the assignees was insufficient to pay the firm creditors in full. It was held that the assets should be marshalled, and that inasmuch as the United States only had a claim against one of the individuals composing the part-

nership, it could not share in the distribution from firm assets.

Mr. Justice Thompson, at page 275 of the opinion, said as follows:

> "If then the debt of the United States is not a lien but only entitled to priority of payment out of the general funds of the debtor in the hands of the assignee, what are the funds out of which this priority is set up in the present case? They are not the funds of John Stouffer, the debtor of the United States, but of John and Jacob Stouffer, who have become insolvent and having no separate property; and the partnership property is insufficient to satisfy the partnership creditors. It is a rule too well settled to be now called in question, that the interest of each partner in the partnership property, is his share in the surplus, after the partnership debts are paid; and that surplus only, is liable for the separate debts of such partner."

In *United States* vs. *Evans* (*supra*) decided by District Judge Hopkinson in 1836, one Jonah Thompson was indebted to the United States as surety on certain bonds. He was also in partnership with George Thompson. The partnership assigned, and the firm assets were insufficient to pay the firm debts. It was held that the United States was not entitled to be paid in preference to the creditors of the partnership.

In *Matter of Flatau* vs. *Stern* (*supra*) the City of New York attempted to collect from firm assets, being administered in the Bankruptcy Court, a personal tax claim against one of the partners, individually. This claim was in identically the same position with respect to firm assets as the claims against Jones and Sells in the present case Ref-

eree Willis, in a well considered opinion, held that the marshalling provisions of the Bankruptcy Act were applicable, and excluded the claim from participation in the firm assets. This decision of Referee Willis was confirmed by the District Court.

The cases cited by the Government in support of its contention are the following:

Lewis vs. *United States,* 92 U. S. 618;
In re Strassburger, No. 13526 Fed. Cases, Vol. 23.

In *Lewis* vs. *United States* (*supra*) the United States had a claim against the partnership of Jay Cook, McCullough & Co. of London (referred to as the English firm). This English firm was composed of seven American partners and three English partners. Jay Cook & Co. of Philadelphia (referred to as the American firm), was composed of the seven American partners of the English firm. On November 26, 1873, the American firm became bankrupt, and Lewis was appointed Trustee in Bankruptcy. The United States asserted against the trustee a claim *against the separate estates of the seven American partners in the* American firm, they being partners in the English firm, which was primarily the debtor to the United States. The Supreme Court decided that the United States, holding a claim primarily against the English partnership, was not bound to go into a foreign jurisdiction to assert its claim against that partnership before proceeding against the separate estates of the partners in this country, but could assert a claim *against the separate estates of the partners* in the possession of Lewis, the trustee in bankruptcy of the American firm. This decision is not authority for the converse proposition

contended for by the Government in this case that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors.

It specifically states the contrary to be the rule. Mr. Justice Swayne, writing for the Court, said at page 624:

> "The bankrupt parties in question were indebted to the United States and they had separate estates. This entitled the United States to the preference claimed. * * *
>
> "The separate and individual interest of the several partners in the partnership property of Jay Cook & Co. can be only the share of each one of what may be left after discharging all the liabilities of the copartnership. This will be nothing, the firm being in bankruptcy and conceded to be hopelessly insolvent. The United States can therefore have no interest with respect to the administration of its affairs."

Each partner is always liable for partnership debts, but the firm is never liable for debts of the partners.

In re Strassburger (*supra*) decided by Mr. Justice Bradley, sitting as Circuit Justice, in 1877, the bankrupts were A. & H. Strassburger, the two members of a copartnership. Between the time of filing the involuntary petition and the adjudication, the United States obtained a judgment against the two bankrupts and one Warren, on a Distillers Bond given by Herman Strassburger, as principal, and Albert Strassburger and Warren as sureties, for Internal Revenue taxes due. The Government claimed priority against the firm assets and its contention was upheld.

On page 224 of the Opinion, Mr. Justice Bradley says:

> "When the United States have a claim against one member of a firm, and not against the other, its priority extends only to the interests of that member, which, as between him and his copartners, is only his share of the partnership assets after all partnership debts are paid. The other partners have a lien on the partnership funds for this purpose; and equity gives the partnership creditors the benefit of this lien when it can do so without violating any principal of law."

This decision was under the Bankruptcy Act of 1867 and was based principally on the holding of the *Lewis* case, 92 U. S. 618, that the United States is not bound by the Bankruptcy Act. This, however, is not the law with respect to the 1898 Bankruptcy Act. Furthermore, in the *Strassburger* case, both partners were liable to the United States for *all of the debt* on the Distillers Bond, which was in effect a joint obligation. There is no such liability in the present case, as each partner is liable only for the tax assessed against him individually. He is in no way liable for the payment of his partners' individual tax. The case is, therefore, within the exception mentioned by Mr. Justice Bradley in the language quoted above. Moreover, the marshalling provisions of the 1898 Bankruptcy Act are more comprehensive and broader than the provisions of the 1867 Act.

POINT III.

There is nothing in the record in this case upon which an equitable lien against partnership assets, may be predicated in favor of the Government.

The question of priority must not be confused with identity of fund against which a claim or lien can be asserted. There is no dispute that a claim of the United States is entitled to priority in the estate against which it is a claim. But that cannot give it any rights in an estate against which it has no claim.

The rights of the United States in such regard (*i. e.*, equitable lien) are governed by the same principles as would apply to any other litigant. There is not one rule for a private suitor and another for the Government.

The contention of the Government appears to be that Jones & Baker, in 1920, realized a profit which resulted in income taxable to the individual partners; that the fund representing the taxable portion of this income, in some way, continued in existence down to and through the Receivership; and that this fund should now be impressed with a lien in favor of the Government for the payment of the additional taxes against the individual partners. The difficulty with this contention is that it runs contrary to well established principles of equity jurisprudence and also that it finds no support in the facts in this case.

An equitable lien is a lien impressed upon specific property, or upon a particular fund capable of ready identification. It has been confined almost entirely to cases where, by agreement of the parties,

a lien was given or was intended and where, for some reason of a technical nature, this lien proved incapable of enforcement, without the interposition of a Court of Equity.

The phrase is used interchangeably with "equitable assignment" and "impressing a trust", and is in a large measure founded on the doctrine of estoppel. In *Lighthouse* vs. *Third National Bank*, 162 N. Y. 336, Judge Werner of the New York Court of Appeals says on page 344 of the opinion:

> "One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.
>
> "Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge." (*Jones on Liens*, sec. 34, and *Grinnell* v. *Suydam*, 3 Sandford, 132.)

In *Pomeroy on Equity*, Fourth Edition, Vol. 3, Sec. 1233, p. 2958, the author defines an equitable lien as follows:

> "It is simply a right of a special nature over the thing, which constitutes a charge or incumbrance upon the thing, so that the very thing itself may be proceeded against in an equitable action, and either sold or sequestered under a judicial decree and its proceeds in the one case, or its rents and profits in the other, applied upon the demand of the creditor in whose favor the lien exists. It is the very essence of this condition that, while the lien continues, the possession of the thing remains with the debtor or the person who holds the proprietary interest subject to the incumbrance. The equitable lien differs essentially from the common-law

lien, which is simply a right to retain possession of the chattel until some debt or demand due to the person thus retaining is satisfied, and possession is such an inseparable element that, if it be voluntarily surrendered by the creditor, the lien is at once extinguished."

To the same effect are

Walker vs. *Brown,* 165 U. S. 654;
Ketchum vs. *St. Louis,* 101 U. S. 306;
Bispham on Equity, 4th Edition, Sec. 351;
In re National Cash Register Co., 174 Fed. 579;
In re See, 209 Fed. 172.

In the present case, there is nothing upon which the Government can predicate a claim of an equitable lien against partnership property. The record is even barren of anything to show that the 1920 income, which forms the basis of these additional taxes, was derived from partnership operations. It might well have been that such income came wholly from sources foreign to the partnership. There is nothing in the present record to show the contrary, and the wide difference in the amounts assessed against the two partners is at least suggestive that the income came from individual, and not partnership operations. The Court cannot, however, indulge in speculation on such a subject. The Government has asserted that a lien exists, and the burden is on it to establish the essential elements of its claim.

But, even if it be assumed that these additional taxes were due to partnership income, there is still no basis for an equitable lien. The partnership was under no obligation to the Government to set aside and hold intact an amount

obligation to pay at the source —

sufficient to liquidate the tax liabilities of the individual partners. Its duty was fully discharged when it furnished the Government with the information necessary to the proper assessment of the taxes against the partners. Otherwise, the plain provisions of the Revenue Act, imposing the tax on the individuals and not on the partnership, would be meaningless.

Furthermore, the practice of the Government in assessing additional taxes years after they are legally due and payable, would make any attempt to create such a fund practically impossible of realization. But, however that may be, the law imposed no such obligation on the partnership and no such fund was in fact created. The Government has not even attempted to identify it, but contents itself with the broad assertion that it has an equitable lien. Clearly, whatever surplus profits there were in the partnership at the end of 1920, have either been withdrawn by the partners or have been lost. If they were withdrawn by the partners for the purpose of paying taxes to the Government, was there an obligation resting on the partnership to see that the withdrawals were properly applied for the purposes intended? And if they were not so applied, are the present creditors of Jones and Baker to be held to have assumed the obligation? These creditors were in no way concerned with the tax liabilities of Jones and Sells to the Government. The property taken over by the Receiver on May 31, 1923, was, in law, their property.

The additional taxes, for which these Government claims have been filed, had not even been assessed at the time of the Receiver's appointment on May 31, 1923. The Government allowed over two years to elapse before the additional assessments

were made, and, during this interval, many innocent creditors had, in good faith, done business with the firm without notice of the Government's claims. Surely, in the light of these facts, there can be no equity in the Government's contention.

On this whole question, the language of Mr. Justice Holmes in *National City Bank* vs. *Hotchkiss*, 231 U. S. 50, at page 57, is most apposite:

> "A trust cannot be established in an aliquot share of a man's whole property, as distinguished from a particular fund, by showing that trust moneys have gone into it. On similar principles, a lien cannot be asserted upon a fund in a borrower's hands, which, at an earlier stage, might have been subject to it, if, by consent of the claimant, it has become a part of the borrower's general estate."

The case relied upon largely by the government, and the opinion in which, is printed as an appendix to their brief (Matter of Brezin & Schaefer), was decided by the United States District Court for the District of New Jersey, prior to the decision of the Circuit Court of Appeals in the instant case. The opinion in the Circuit Court of Appeals (Rec. p. 57) discusses the case and cites fully the authorities which led that court to believe that the decision was incorrect.

The unsoundness of Judge Runyon's decision in the Brezin & Schaefer case is also readily seen by a reading of the following quotation from his opinion:

> "At all times, during the years in question, as already said, there were funds in the business to which each partner, under the articles of copartnership, might have laid claim as his own. They were his to do with as he pleased, and they were the very funds which, in part,

> served as the foundation for the imposition of the tax, collection of which is herein sought. The fact that each partner was willing to forego the physical withdrawal of these funds can not, in my opinion, succeed in defeating the government's equitable lien."

This entirely ignores the fact, evidenced by the firm being in bankruptcy, that the partners have done with these funds as they pleased and that they have withdrawn and spent them either in the conduct of firm business, or for personal uses.

Judge Runyon further says:

> "Therefore, in my opinion, the government's claim, being in the nature of an equitable lien, has followed the property into the hands of the trustee in bankruptcy, where it awaits satisfaction."

But, here again he is giving weight to form, and not substance. If, when the receiver took possession, he had found a package of money or a special deposit labeled or indicated as income of the particular year for which the tax was assessed, then there might have been something to follow, but here there is no attempt whatever to identify what is sought to be followed and, of course, no such identification could be made.

The case of *Titus* v. *Maxwell*, referred to at length by the government (brief, p. 18) is not in point here, as a statement of the facts of that case will show. In that case it was the individual partner (the mortgagee) who was in bankruptcy. The other partner, Johnson, was conceded not to be insolvent, and the mortgage was held by an assignor who had taken for value. The firm had not been adjudicated bankrupt. So that it was the indi-

vidual estate that was being administered. The Court said (281 Fed., p. 438):

> "Here the partnership has not been adjudged bankrupt, nor has Johnson [the other partner] been so adjudged. The Bankruptcy Act does not change the rule that the partnership may be in bankruptcy and the partners not. * * * It is equally manifest that a partner may be in bankruptcy and the partnership not, and that a partnership is not insolvent so long as any of its members has property enough to accomplish satisfaction of the debts of that member together with the partnership debts."

The quotation from that case in the government's brief is misleading because it leaves out an important portion of the paragraph quoted. The paragraph down to the point where the government's quotation ends reads as follows, the portions omitted by the government being in italics:

> "It was long since declared to be the rule in equity that the right of partnership creditors to appropriate the partnership property specifically to the payment of their debts is derived, not through specific lien, but by a sort of subrogation through the partner whose original right it was to have the partnership assets applied to the payment of partnership obligations; that this equity of the partnership creditors subsists so long, and so long only, as that of the partner through whom the equity is derived remains; *that is to say, 'so long as he retains an interest in the firm assets, as a partner, a court of equity will allow the creditors of the firm to avail themselves of his equity, and enforce, through it, the application of those assets primarily to payment of the debts due them, whenever the property comes under its administration'; but that 'if, before the interposition of the court is asked,*

the property has ceased to belong to the partnership, and if by a bona fide transfer it has become the several property either of one partner or of a third person, the equities of the partners are extinguished, and consequently the derivative equities of the creditors are at an end."

POINT IV.

The decree of the District Court, as affirmed by the Circuit Court of Appeals, should be affirmed.

Inasmuch as the government has no claim or lien against the assets of the firm of Jones & Baker on account of additional income taxes assessed against Jones and Sells as individuals, the order appealed from was properly entered and should be affirmed.

Dated, January 5, 1925.

Respectfully submitted,

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